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ECONOTE No. 67: Keep totally clear of any form of crypto currencies and ICOs. Please! 30/12/2017

Summary

Bitcoins and cryptocurrencies ("cryptos") are computer-generated units of nothing. No intelligent person should have anything to do with them, let alone invest in them**.**

Econotes avoids statements such as "as we told you so X months ago, and now our suggestion is making millions" not only because we had not made such investment suggestions, but because we believe that investors are intelligent enough not to need reminders. However we "did tell you so" in Econote No. 66, which was virulently anti-crypto, to stay clear of them. The debacle during December (see Fig. 1) supported fully our position. We add here a few more nails, hopefully, to the coffin of this financial aberration

Investment Conclusions

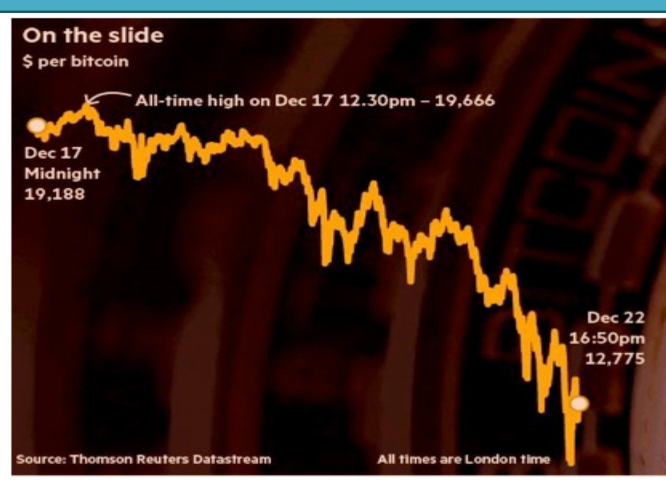
The volatility of most cryptos, such as that during December 2017, can be expected when investors buy an "asset" solely on the expectation that other people will buy it too, and not because of the prospective earnings and capital appreciation of whatever underlies that asset. In cryptos there is nothing underlying them. Furthermore, their supply is dependent on software used by anyone with a computer and can be produced out of thin air. Use of cryptos in Initial Coin Offerings (ICOs) is equally absurd despite the issued cryptos being exchangeable for some concrete assets. Why not use USDs? In sum : Stay clear of cryptos and ICOs.

How banking works and cryptos do not.

One of the most frequently touted argument in support of the cryptos is that their generation out of thin air by anyone , liberate the people from the tyrany and exploitatIon of central banks.Furthermore the use of blockchain technology (which, incidentally, has nothing to do specifically with cryptos as it is just a data handling software) also liberates the people from the tyranny of the payments system run by banks. Now anyone can pay to or receive from anyone else through a blockchain system away from the prying eyes (and charges) of the banking system.These claims are packed with undiluted ignorance of double entry book keeping and how the central banking and commercial banking systems work. Consider the following:

What is used as money in all economies (meaning a form of asset commonly accepted to buy/sell goods, services and assets with and to accumulate wealth or future purchasing power) is the liabilities of the central bank and of licensed and supervised banks.If people wish to use their old shoes and/or their discarded underwear as money, and other people accept them, that is their privilege (and, ultimately,their funeral too…. read on).The two key liabilities of a central bank are their note issue and and the deposits of the government and of other banks.As all liabilities are backed by assets, the assets backing the liabilities of the central bank are mostly government bonds and high quality bonds or loans issued by the private sector.Central banks do not create money out of the nothing, they create it by lending to the government and selectively to other institutions and banks.Ditto for the liabilities of the private sector banks. Their deposits, forming over 95% of the money stock in modern economies, are backed by assets, mostly loans to people, firms, to other banks and to the government. Banks do not create deposits out of thin air, but by lending and, hence, their liabilities are always fully backed by assets. Assets can fail and banks can go bankrupt, but money is not created out of nothing. Cryptos, created by computers, are backed by nothing.

Fig.1 Bitcoin price in USD terms, December 2017



Source: FT

ECONOTE No.67

Why cryptos and ICOs are not a fraud but a sham

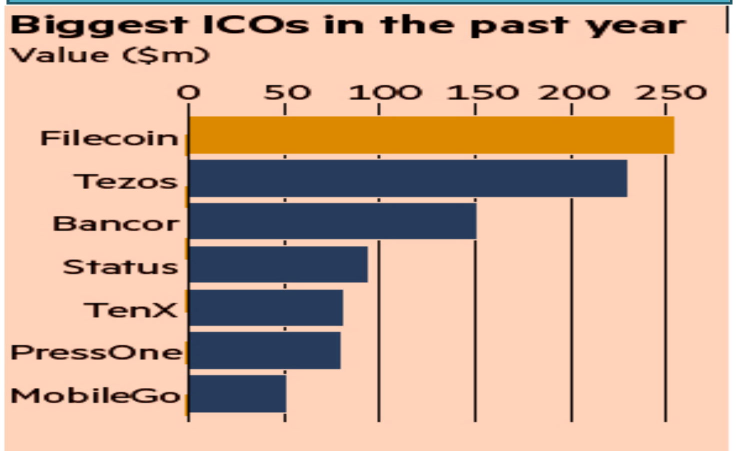
There are now about 1,372 different crypto "coins" in circulation with a value of USD 588 bl at yearend 2017. We have stated in Econote No. 66 why cryptos can only benefit their issuers and not the punters who buy them.The reason for this is basically a version of seigniorage tax, the latter being a term used to define the difference between the actual value of gold in a gold coin and the the value of the coin itself.Issuers of gold coins habitually included less than one fine ounce of gold in a one ounce coin but charged the full one ounce cost ! In modern central banking the central bank, here the Fed, prints one USD dollar bill with which then it buys one USD worth of US treasuries.The Government receives one USD loan and pays the Fed interest on the bonds bought.The Fed benefits to the tune of the difference of the printing costs of the note and the interest received.

Fact Box: Who gains by "printing" money?

Why should we let the central and commercial banks have the privilege of creating money ? Simply because banks are regulated and the deposits they create can be repaid by the sale of the assets which back them.Central banks assume the responsibility of making sure that, if bank lending goes wrong, they will have the right and the power to support the financial system and depositors.This did happen in 2008-9 crisis and, yes , banks had lent irresponsibly but central banks saved the day.In the case of cryptos, once the punters have parted with their USD in exchange , there is nothing to back the cryptos or or guarantee their "repayment" or value.Also note that nearly all cryptos trade for USD and not other cryptos ! Ahem! So much for cryptos replacing the hated "central bank" money !

The Fed can, of course, return the interest to the government thus providing it with an interest -free loan.All of us clinging to USD notes, provide the US government with interest- free loans ! So issuers of cryptocoins receive USD or other currencies from the punters who buy them, and can use these funds to invest, spend etc.The punter has a crypto whose only value is the likelihood that it may appreciate.No interest is received and there is no way of "returning" the crypto back for the USD paid.If the market (other punters) ceases to believe in the cryptos, they just lose all their value with nothing to back them up.Should cryptos replace the national currencies and should a financial crisis occur, there will be no central institution to turn to for support but only thousands of anonymous programmers pushing more buttons and producing more worhless cryptos. Not nice !

Fig.2: ICO offerings, to Sept. 2017



Source: FT

In sum: Please use reason and stay clear from cryptos and ICOs

All these arguments over the insanity of even treating cryptos seriously, including trading them in futures markets (shame on them, chasing after the commissions !) apply with a vengeance to ICOs.Figure 2 shows the value of ICOs to September 2017.The companies involved are all tech related.Not a great deal of money is involved , about USD 1.32 bl by 3Q.17, but nonetheless a sham, as the punters were given cryptos in return of promises of a later switch to actual shares of a future undertaking.In-between the only way of getting the money back is to sell the crypto to another punter.Sanely and honourably the S.Korean and Chinese authorities forbade ICOs, but in other countries, including the US, the authorities issued warning and are considering treating ICOs as IPOs with the all the consequent regulatory obligations which would normally kill these financial aberrations.Anyone considering putting money in an an ICO must ask the question why issue cryptos for an investment in a tech company rather than issue the shares themselves denominated in USD.This would avoid the double risk of having the investment diminish in value not only because the price of the crypto issued in USD falls but also because the nefarious project on which the money will be invested never materialises or the expected returns fall. Last but not least, please do not be confused by the use of blockchain technology and cryptos, they are not the same thing.Blockchain is a data handling software, nothing else.Allowing one-on-one deals with total privacy sounds great till your money dissappears with no recourse to anyone including the hated banks which now run the payments system. Andrew Freris(writing completed 30/12/2017)